Statement of
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Before a Joint Hearing of the
Committee on Environment and Public Works
and the
Committee on Finance
United States Senate
September 25, 2002

Chairman Jeffords, Chairman Baucus, Ranking Members Smith and Grassley, and Members of the Committees:

Thank you for holding this hearing today and inviting me to testify on Federal innovative finance initiatives for surface transportation projects. These financing techniques, in combination with our traditional grant programs, have become important resources for meeting the transportation challenges facing our Nation. Secretary Mineta, in his testimony last January before the Environment and Public Works Committee, indicated his desire to increase their application.

The Secretary stated that "Expanding and improving innovative financing programs in order to encourage greater private sector investment in the transportation system..." will be one of the Department of Transportation's core principles in working with Congress, State and local officials, tribal governments and stakeholders to shape the surface transportation reauthorization legislation. He remains steadfast in his support for these programs.

Defining "Innovative Finance"

Perhaps the first issue to address today is "What is innovative finance?" We increasingly hear the term used in the context of transportation projects, but what does it really mean? We at the Department apply the term to a collection of management techniques and debt finance tools available to supplement and expand the flexibility of the Federal government's transportation grant programs. We see the primary objectives of innovative finance as leveraging Federal resources, improving utilization of existing funds, accelerating construction timetables, and attracting non-Federal investment in major projects. The quantifiable successes of such innovative finance are beginning to mount.

The July 2002 report entitled "Performance Review of U.S. DOT Innovative Finance Initiatives" states that Federal investments of $8.6 billion have helped to finance projects worth a total of $29 billion, a ratio of $3.40 invested for each Federal dollar. Of this $29 billion, more than 27 percent, or $8 billion, consists of debt that will be repaid from new revenue sources. Sponsors report that more than 50 projects were accelerated from six months to 24 years as a result of innovative financing compared to transportation grants. The total economic impacts of $91 billion nationwide represent benefits that have accrued more rapidly than ever possible using a pay-as-you-go method.

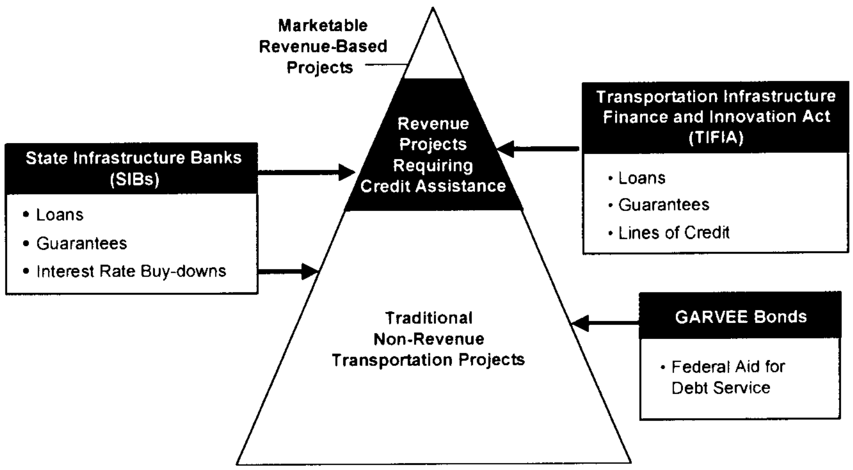
While these achievements demonstrate the value of innovative finance techniques and tools, they also deserve a realistic assessment in the context of the grant system, financed by the Highway Trust Fund, that provides the foundation of Federal financial assistance for surface transportation projects.

The first assessment in realism is to examine the "innovative" nature of the financial tools. Improving the flexibility of fund administration and creating opportunities to borrow and lend Federal money have been vitally important initiatives, and we can thank numerous role models outside the transportation sector for developing these tools long ago. The "new" or "innovative" feature of these tools, then, derives from their application to the Federal transportation program. Further, these financing techniques have now become better known and accepted by many State and local transportation partners. Because the demand for transportation investment throughout the country consistently exceeds the supply of resources, those regions facing the greatest challenges to mobility have readily embraced -- and in many cases paved the way for -- the opportunities provided by innovative finance.

The second assessment concerns the potential for innovative finance to ease demands on the current grant funding distributed each year to States and local agencies. That doesn't seem likely. The focus of innovative finance (and perhaps a more appropriate term to designate these tools) is project finance. The techniques supplement existing programs on an as-needed, project-by-project basis. Transportation officials must evaluate each project individually to determine the best financing approach. The grant programs remain the bulk of Federal transportation assistance, supplemented by the extra muscle and flexibility of innovative finance.

The diagram below depicts a pyramid that illustrates the range of surface transportation projects and the innovative tools available for financing them. The base represents the majority of projects: those that rely on grant-based funding, but may benefit from measures that enhance flexibility and resources. Various Federal funds management techniques, such as advance construction, tapered match, and grant-supported debt through Grant Anticipation Revenue Vehicles, or GARVEEs, can help move these projects to construction more quickly. The mid-section represents those projects that can be partially financed with project-related revenues, but may also require some form of public credit assistance. State Infrastructure Banks (SIBs) can assist state, regional, and local projects through low-interest loans, loan guarantees, and other credit enhancements. State loans of Federal grant funds known as Section 129 loans represent another credit assistance technique. The Transportation Infrastructure Finance and Innovation Act (TIFIA) program provides credit assistance to a small number of large-scale projects of regional or national significance that might otherwise be delayed or not constructed at all because of risk, complexity, or cost. The peak of the pyramid reflects the very small number of projects able to secure private capital financing without any governmental assistance.

Federal Project Finance Tools for Surface Transportation



The TIFIA Credit Program

Let me begin with the program that, through the leadership of the Senate during enactment of the Transportation Equity Act for the 21st Century (TEA-21), provides a direct role for the Federal government to assist large transportation projects. In June 2002, the Department delivered its Report to Congress on the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA), which authorizes the Department of Transportation (DOT) to provide three forms of credit assistance – secured (direct) loans, loan guarantees and standby lines of credit – to surface transportation projects of national or regional significance.

The public policy underlying the TIFIA credit program asserts that the Federal Government can perform a constructive role in supplementing, but not supplanting, existing capital finance markets for large transportation infrastructure projects. As identified by Congress in TEA-21, "...a Federal credit program for projects of national significance can complement existing funding resources by filling market gaps, thereby leveraging substantial private co-investment." Because the TIFIA program offers credit assistance, rather than grant funding, its potential users are infrastructure projects capable of generating their own revenue streams through user charges or other dedicated funding sources.

Identifying a constructive role for Federal credit assistance begins with the acknowledgement that, compared to private investors, the Federal Government's naturally long-term investment horizon means that it can more readily absorb the relatively short-term risks of project financings. Absent typical capital market investor concerns regarding timing of payments and financial liquidity, the Federal Government can become the "patient investor" whose long-term view of asset returns enables the project's non-Federal financial partners to meet their investment goals, allowing the project's sponsors to complete a favorable financing package.

The TIFIA program's pragmatic challenge is to balance the objective of advancing transportation projects with the equally important need to lend prudently and protect the Federal interest. The DOT must apply rigorous credit standards as it fashions assistance to improve the financial prospects of participating projects. The Federal objective is not to minimize its exposure but to optimize its exposure—that is, to take prudent risks in order to leverage Federal resources through attracting private and other non-Federal capital to projects.

The TIFIA program assistance is meant to support expensive, complex and significant transportation investments. In general, a project's eligible costs must be reasonably anticipated to total at least $100 million. Credit assistance is available to highway, transit, passenger rail and multi-modal projects. Other types of eligible projects include intercity passenger rail or bus projects, publicly owned intermodal facilities on or adjacent to the National Highway System, projects that provide ground access to airports or seaports, and surface transportation projects principally involving the installation of Intelligent Transportation Systems (ITS), for which the cost threshold is $30 million. The TIFIA credit assistance is limited to 33 percent of eligible project costs.

Congress has authorized the DOT to provide up to $10.6 billion of TIFIA credit assistance through the TEA-21 authorization period of 1998-2003. From the Highway Trust Fund, Congress authorized $530 million, subject to the annual obligation limitation on Federal-aid appropriations, to pay the subsidy cost of TIFIA credit assistance and related administrative costs. The subsidy cost calculations establish the capital reserves which the DOT must set aside in advance to cover the expected long-term cost to the Government of providing credit assistance, pursuant to the Federal Credit Reform Act of 1990 (FCRA).

To date, the DOT has selected 11 projects, representing $15.7 billion in transportation investment, to receive TIFIA credit assistance. The TIFIA commitments total $3.7 billion in credit assistance at a subsidy cost of about $202 million. The DOT has received 38 letters of interest and 15 applications from project sponsors. All major categories of eligible projects – highway, transit, passenger rail and multi-modal – have sought and received credit assistance. The TIFIA credit assistance ranges in size for each project, from $73.5 million to $800 million, mostly in the form of direct Federal loans from the DOT to the project sponsors. These projects are summarized in the table below.

TIFIA Commitments as of September 2002

Project	Project Type	Project Cost	Instrument Type	Credit Amount
Miami Intermodal Center	Intermodal	$1,349 million	Direct Loan	$269 million
			Direct Loan	$163 million
SR 125 Toll Road	Hwy/Bridge	$450 million	Direct Loan	$94 million
			Line of Credit	$33 million
Farley Penn Station	Passenger Rail	$800 million	Direct Loan	$140 million
			Line of Credit	$20 million
Washington Metro CIP	Transit	$2,324 million	Guarantee	$600 million
Tren Urbano (PR)	Transit	$1,676 million	Direct Loan	$300 million
Tacoma Narrows Bridge	Hwy/Bridge	$835 million	Direct Loan	$240 million
			Line of Credit	$30 million
Cooper River Bridge	Hwy/Bridge	$668 million	Direct Loan	$215 million
Staten Island Ferries	Transit	$482 million	Direct Loan	$159 million
Central Texas Turnpike	Hwy/Bridge	$3,580 million	Direct Loan	$917 million
Reno Rail Corridor	Intermodal	$242 million	Direct Loan	$51 million
			Direct Loan	$5 million
			Direct Loan	$18 million
SF-Oakland Bay Bridge	Hwy/Bridge	$3,305 million	Direct Loan	$450 million
Total		**$15, 711 million**		**$3,704 million**

Already limited by statute to 33 percent of total project costs, actual TIFIA assistance has averaged 23 percent of project costs. Including grant assistance, total Federal investment in TIFIA projects amounts to 43 percent of total costs. Investments from other government and private sources comprise the remaining 57 percent.

Because credit assistance requires a small fraction of the contract authority needed to provide a similar amount of grant assistance, TIFIA promotes a cost-effective use of Federal resources to encourage co-investment in transportation infrastructure. Federal grant funds that otherwise might be required to support these large projects can then be redirected toward smaller but critical infrastructure investments.

An explicit goal of the TIFIA program is to induce private investment in transportation infrastructure. Private co-investment in the TIFIA project selections totals about $3.1 billion, comprised of more than $3 billion in debt (including state and local debt held by private investors) and nearly $100 million in equity. This co-investment totals approximately 20 percent of the nearly $15.7 billion in total costs.

The DOT believes that a limited number of large surface transportation projects each year will continue to need the types of credit instruments offered under TIFIA. Project sponsors and DOT staff are still exploring how best to utilize this credit assistance, and we welcome Congressional guidance and dialogue during this evolutionary program period.

As stated in the Conference Report accompanying TEA-21 and TIFIA, "[a] n objective of the program is to help the financial markets develop the capability ultimately to supplant the role of the Federal Government in helping finance the costs of large projects of national significance." The current form of TIFIA administration – within a Federal agency subject to regular budget oversight – enables policymakers to monitor program performance as staff, sponsors and the financial markets gain experience. As current TIFIA projects move into their construction, operation and repayment phases, and as additional projects obtain TIFIA assistance, policymakers will acquire better information with which to determine whether TIFIA should remain within the DOT, "spin off" into a Government corporation or Government sponsored enterprise, or phase out entirely and rely on the capital markets to meet the program's objectives.

The Department also administers a credit assistance program specifically for the railroad industry: the Railroad Rehabilitation and Improvement Financing Program (RRIF). Also authorized in TEA-21, the RRIF program provides direct loans and loan guarantees to railroads and other public and private ventures in partnership with railroads. The aggregate unpaid principal amount under the program cannot exceed $3.5 billion, and the subsidy cost is covered by a "credit risk premium" paid by or on behalf of the borrower from a non-Federal source. To date, the Federal Railroad Administration (FRA) has approved four RRIF loans for a total of more than $200 million, and six more applications are currently being evaluated.

GARVEE Bonds

Another financing tool among States has been the issuance of Grant Anticipation Revenue Vehicles (GARVEEs): bonds that enable states to pay debt service and other bond-related expenses with future Federal-aid highway apportionments. States are finding GARVEEs to be an attractive financing mechanism to bridge funding gaps and accelerate construction of major corridor projects. The GARVEE generates up-front capital for major highway projects at tax-exempt rates and enables a state to construct a project earlier than using traditional pay-as-you-go grant resources. With projects in place sooner, costs are lower due to inflation savings and the public realizes safety and economic benefits. Paying via future Federal highway reimbursements spreads the cost of the facility over its useful life, rather than just the construction period. GARVEEs expand access to capital markets, supplementing general obligation or revenue bonds.

A GARVEE is a debt-financing instrument authorized to receive Federal reimbursement of debt service and related financing costs. In general, projects funded with the proceeds of a GARVEE debt instrument are subject to the same requirements as other Federal-aid projects with the exception of the reimbursement process. Instead of reimbursements as construction costs are incurred, the reimbursement of GARVEE projects occurs when debt service is due.

Candidates for GARVEE financing are typically large projects, or a program of projects, where the costs of delay outweigh the costs of financing and other borrowing approaches may not be available. In total, six states have issued 14 GARVEE Bonds, totaling more than $2.5 billion, to be repaid using a portion of their future Federal-aid highway funds. The table below summarizes this activity.

GARVEE Transactions as of July 2002

State	Date of Issue	Face Amount of Issue	Projects Financed
Ohio	May-98 Aug-99 Sep-01	$70 million $20 million $100 million	Various projects including: Spring-Sandusky and Maumee river improvements
New Mexico	Sep-98 Feb-01	$100 million $19 million	New Mexico SR 44
Arkansas	Mar-00 Jul-01 Jul-02	$175 million $185 million $215 million	Interstate Highways
Colorado	May-00 Apr-01 Jun-02	$537 million $506 million $208 million	Any project financed wholly or in part by Federal funds
Arizona	Jun-00 May-01	$39 million $143 million	Maricopa freeway projects
Alabama	Apr-02	$200 million	County Bridge Program
Total		**$2,517 million**	

State Infrastructure Banks

Another significant project finance tool is the State Infrastructure Bank (SIB), a revolving transportation investment fund administered by a State. A SIB functions as a revolving fund that, much like a bank, can offer loans and other credit products to public and private sponsors of Title 23 highway construction projects or Title 49 transit capital projects. Federally capitalized SIBs were first authorized under the provisions of the National Highway System Designation Act of 1995. The initial infusion of Federal and state matching funds was critical to the start-up of a SIB, but states have the opportunity to contribute additional state or local funds to enhance capitalization. SIB assistance may include loans (at or below market rates), loan guarantees, standby lines of credit, letters of credit, certificates of participation, debt service reserve funds, bond insurance, and other forms of non-grant assistance. As loans are repaid, a SIB's capital is replenished and can be used to support a new cycle of projects. And, as has been accomplished in

Minnesota and South Carolina, SIBs can also be structured to issue bonds against their capitalization, increasing the amount of funds available for loans.

SIBs complement traditional funding techniques and serve as a useful tool to stretch both Federal and state dollars. The primary benefits of SIBs to transportation investment include:

- Flexible project financing, such as low interest loans and credit assistance that can be tailored to the individual projects;
- Accelerated completion of projects;
- Incentive for increased state and/or local investment;
- Enhanced opportunities for private investment by lowering the financial risk and creating a stronger market condition; and
- Recycling of funds to provide financing for future transportation projects.

The pilot program was originally available to only 10 states, and was later expanded to include 38 states and Puerto Rico. TEA-21 established a new pilot program for the states of California, Florida, Missouri, and Rhode Island. Texas was later authorized to participate in the TEA-21 program. To date, however, only Florida and Missouri have elected to revise their agreements in accordance with TEA-21.

The authorizing Federal legislation allows States to customize the structure and focus of their SIB programs to meet specific requirements. While a SIB can offer many types of financing assistance, loans have been the most popular tool. As of June 2002, 32 states had entered into 294 loan agreements totaling more than $4 billion. This activity has been largely concentrated within six States. The largest SIB, the South Carolina Transportation Infrastructure Bank, has approved financing and begun development of almost $2.4 billion in projects, helping to condense into seven years a transportation program that would have taken 27 years under a pay-as-you-go approach. The Florida SIB had executed 32 loan agreements through the end of FY 2001, at a value of $465 million. The Florida SIB has been augmented with a state appropriation of $150 million, and both Ohio and Arizona have also contributed additional state funds to their SIBs. The table below demonstrates the concentration of activity in the six largest SIBs.

State Infrastructure Banks Transactions as of June 2002

State	Number of Agreements	Loan Agreement Amount
South Carolina	6	$2,382 million
Florida	32	$465 million
Arizona	37	$424 million
Texas	37	$252 million
Ohio	39	$141 million
Missouri	11	$73 million
Subtotal	**162**	**$3,738 million**
Other States	132	$318 million
Total	**294**	**$4,056 million**

Looking Ahead

Although States and local partners have not adopted them evenly, the tools of TIFIA, GARVEEs and SIBs have clearly moved from the innovative to the mainstream. This reflects significant success, but it doesn't indicate that the needs of project finance have been completely met. Secretary Mineta has issued a clear challenge to the Department in our development of a reauthorization proposal for TEA-21, asking us to expand innovative finance programs to encourage private sector investment and examine other means to augment existing revenue streams. As part of our internal reauthorization deliberations, we are considering options for further leveraging Federal resources for surface transportation. Enhancing the use of innovative finance in intermodal projects and examining the financing techniques used in other major public infrastructure investments are among the areas we are looking at. The challenge is to build on our successes to date, but not set unrealistic expectations for the future.

A particular focus is on the issue of private investment, an at-risk contribution to a project with the expectation of repayment from project revenues – and a return on investment – over time. Unlike much of the world, the provision of roads and transit systems in the U.S. is almost completely a public sector responsibility. As has been often pointed out, our system of tax-exempt financing means that the public cost of capital is significantly less expensive than for a private entity. Many public works sectors in the U.S. permit private firms to gain access to tax-exempt capital for the construction of public infrastructure. Legislation has been introduced previously to confer this opportunity to a limited number of highway projects. Before the Department would consider any proposed amendment to the Internal Revenue Code, it would first consult with the Department of the Treasury.

One transportation sector with a high degree of private participation, which deserves a higher profile among public transportation planners and policy makers, concerns the movement of freight. Supporting the efficiency of commercial freight transportation continues to be a cornerstone of the Department's vision for America's transportation system. ISTEA and TEA-21 legislation gave us many tools to bring this vision to reality, and our experience has given us new ideas for programs that will get us even closer to our goal of a seamless transportation network. Greater investments in transportation infrastructure and wider use of information technology will certainly be required to achieve this goal.

The activity of SIBs in many States indicates that this program is ready to move beyond its pilot phase to become a permanent feature of the innovative finance landscape.

The Department looks forward to working with our partners in State DOTs, metropolitan planning organizations, and private industry to apply innovative funding strategies that extend the financial means of our individual stakeholders. And we look forward to working with the Congress to craft the next surface transportation legislation. Working together, the Administration, the Congress, States and localities and the private sector can preserve, enhance, and establish surface transportation programs that will result in increased mobility, safety and prosperity for all Americans.

Thank you for the opportunity to testify before you today. I would be happy to answer any questions you may have.